

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)	
)	
1998 Biennial Regulatory Review--)	CC Docket No. 98-81
Review of Accounting and Cost)	
Allocation Requirements)	
)	
United States Telephone Association)	ASD File No. 98-64
Petition for Rulemaking)	

TO: THE COMMISSION

COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY,
PACIFIC BELL AND NEVADA BELL

SOUTHWESTERN BELL TELEPHONE COMPANY
PACIFIC BELL
NEVADA BELL

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CC Docket No. 98-81

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SUMMARY*

The Section 11 Biennial Review of Parts 32 and 64 should include a comprehensive review of all accounting and cost allocation rules. Instead, the NPRM proposes relief from detailed Class A accounting requirements only for the mid-sized ILECs and very limited relief for the largest ILECs. If these proposals were adopted, 90% of the industry would receive virtually no relief from the burden of such regulations. In order to properly perform an exhaustive review of all rules and regulations in this area, the Commission should expand the scope of its review in this proceeding to include, at a minimum, all of the accounting and cost allocation requirements identified by USTA and by SBC in its Section 11 Petition. This review should include a quantitative or qualitative analysis of the cost of regulation as compared to its expected benefit.

As demonstrated in Arthur Andersen's Whitepaper, the accounting, recordkeeping and cost allocation requirements are among the most burdensome compared to ILECs' competitors and other industries, the most excessive compared to what is truly necessary in today's environment, and the most ripe for review and comprehensive simplification. It is not in the public interest to continue requiring price cap ILECs to comply with excessively and unnecessarily detailed accounting, recordkeeping and cost allocation requirements, designed for a rate-of-return environment, when their competitors' activities are not subject to any of the same type of regulatory impediments at all.

Under Section 11, the Commission needs to consider the high level of competitive activity facing the ILECs, both the mid-sized and the largest ILECs. Instead of removing or

* The abbreviations used in this Summary are defined in the body of these Comments.

streamlining regulation where there is more competitive activity, the NPRM uses the contention that there is a higher level of competitive activity among the largest ILECs as a justification for retaining the detailed Class A regulation only in the case of the largest ILECs.

Under Illinois Public, the Commission will not be able to justify the differential treatment of the BOCs compared to the mid-sized ILECs. The NPRM's first reason for its partial exemption is that "the largest incumbent LECs tend to conduct a much greater transactional volume of competitive services than the smaller and mid-sized carriers." On the contrary, the percentage of nonregulated activity reported by a typical mid-sized company is comparable to or greater than the percentage of nonregulated activity reported by the BOCs. For example, on the average, about 17% of the mid-sized ILECs' operating expenses are nonregulated, as compared to only 8.6% of the SBC LECs' operating expenses.

There are ample reasons to exempt all ILECs from Class A accounting requirements. Class A accounts are no longer necessary for the Commission to perform essential regulatory functions. Part 36 separations can function using Class B accounts. The primary safeguard against cross-subsidy (aside from price cap regulation), the Part 64 cost allocation rules, can function equally well using Class B accounts as it does using Class A accounts.

A separate reason provided by the NPRM for continuing to apply the Class A accounts to the largest ILECs is to ensure compliance with Sections 260, 271-276 and 254(k) of the Communications Act. However, the Commission can enforce these sections even if an ILEC uses Class B accounts. These sections are concerned with the protection of ratepayers from cross-subsidizing nonregulated or competitive activities. Aside from price cap regulation, Part 64 cost allocation is the primary regulatory tool to protect ratepayers from cross-subsidy. A Class B CAM is equally as effective as a Class A CAM in performing this regulatory function.

The accuracy of the CAM process will not be affected at all by a change from Class A to Class B because the underlying cost pools will continue to contain all the necessary details concerning costs.

Given the reduced importance of Part 32 book costs, the same intense regulation of accounting that was adopted under rate-of-return regulation is no longer justified under price cap regulation. In any event, in view of the NPRM's inability to distinguish mid-sized ILECs from the largest ILECs, the latter, all being subject to price cap regulation, are entitled to no less deregulatory relief from the Class A accounting and CAM rules than the mid-sized ILECs.

The accounting and cost allocation requirements have outlived their usefulness in accomplishing many of the original objectives for which they were adopted. The NPRM exaggerates the benefits of the Class A accounting detail and underestimates the burden of complying with the Part 32 accounting requirements. While it is true that ILECs maintain internal financial records in greater detail than the Class A details, the type of detail maintained for internal purposes is different from that required by the Class A accounts. The burden of Part 32 is the requirement to maintain a different set of details for regulatory purposes that ILECs do not need for their own internal management purposes. The fact that ILECs maintain detailed internal financial information does not reduce at all the burden imposed by Class A accounting.

The burden of maintaining Class A accounting details is significant, as evidenced by the larger number of employees that the largest ILECs need compared to competitors and companies in other industries. Given that Part 32's usefulness in accomplishing any of the Commission's regulatory objectives is very limited under price cap regulation in a competitive local exchange environment, the necessity of maintaining the Class A accounting details is far outweighed by their burden, especially for price cap ILECs. In fact, the benefit of maintaining Class A accounts

versus Class B accounts is virtually nil because many of the regulatory mechanisms that rely upon accounting information, such as the part 64 CAM, will be just as effective using Class B accounts.

The proposed streamlining of the Part 64 independent audit should apply to all ILECs. Given the reduced importance of cost allocation rules in the prevention of cross-subsidy, annual CAM audits are far less important than when they were adopted for purposes of traditional rate-of-return regulation. Periodic audits, such as every two years, using attestation standards, would be far more efficient and would practically cut the resources used in half.

Out of the numerous specific account changes presented by USTA and several ILECs, the NPRM has selected only one token recommendation: to consolidate Accounts 2114-2116 into a single investment account and Accounts 6114-6116 into a single expense account. The reduction in burden achieved by this consolidation would be barely noticeable. In order to yield meaningful deregulatory results, this same type of consolidation should be carried throughout Part 32. As part of its "attic-to-basement" review of accounting rules, the NPRM should consider all of USTA's proposals as well as those set forth in SBC's Section 11 Petition.

Accounts 2114-2116 can be consolidated without any adverse consequences. The same can be said with regard to other groups of accounts in the Class A system of accounts. If Accounts 2114-2116 can be consolidated, there is no reason that the same analysis would not produce a consolidation of other groups of accounts, perhaps up to and including the Class B level. The Commission should consolidate other accounts, such as switching accounts (Accounts 2211, 2212 and 2215) and cable and wire accounts (2421-2426 and 2431).

For purposes of the consolidations of groups of accounts, the Commission's depreciation practices should not be the controlling criterion because, pursuant to Section 11, ILECs should

be relieved of Commission-prescribed depreciation rates. Since there is only one isolated difference between the jurisdictional separations rules for Class A and Class B companies, the Part 36 separations rules also need not play any part in deciding whether to consolidate accounts.

Instead of the “drop-in-the-bucket” approach reflected in the NPRM’s limited proposal to consolidate only 6 out of 261 accounts, the Commission should undertake a comprehensive review of each and every group of accounts in Part 32 to assess whether the same detailed categories are still necessary.

The SBC LECs are in full agreement with the proposal to consolidate all nonregulated revenue in a single account, Account 5280. There is simply no reason to require disaggregated reporting of the revenue from different types of nonregulated activities.

Price cap ILECs should be permitted to adopt new accounting standards prescribed by the FASB without any requirement to notify, or obtain approval from, the Commission. Since there is no regulatory benefit to be served by requiring studies of the financial impact of new accounting standards in the case of price cap ILECs, the burden of Section 32.16 is clearly not justified by any regulatory benefit.

The property recordkeeping and depreciation requirements are among the most burdensome of the Part 32 requirements, and thus, certainly should not be overlooked in performing the biennial review process. In contrast, the NPRM barely scratches the surface of the Part 32 recordkeeping requirements by proposing to eliminate a recordkeeping approval requirement in Section 32.2000(b) that ILECs are seldom required to use. This is not even the “tip of the iceberg” among the excruciatingly detailed journal entries and other records required by Part 32 as applied to ILECs. There is no further benefit in requiring price cap ILECs to maintain property records at an excessive level of detail.

Price cap ILECs should not be required to keep detailed records concerning millions of individual property record units, including those of extremely small value. Each of the largest ILECs must keep track of over 50 million individual property units under Part 32 compared to generally less than one million for a comparable nonregulated company. Requiring ILECs to keep track of fifty times as many units of property as their competitors at up to four times the cost, and for no apparent reason in the case of price cap ILECs, has a crippling effect on the ILECs' ability to compete efficiently with those who are not burdened by these requirements.

Instead of the "tip-of-the-iceberg" approach, the Commission should undertake a comprehensive review of all of the Part 32 recordkeeping requirements with a view to eliminating not merely those requirements that are seldom applicable, but, instead, the vestiges of the rate-of-return recordkeeping requirements that impose daily burdens on numerous employees.

The Commission should adopt a forward-looking blueprint to guide its regulation in areas such as this. To properly consider competition, and the resulting changes in the public interest analysis, this roadmap must be designed not only based on the unprecedented changes in the industry since the last comprehensive review of the accounting and cost allocation rules, but the changes that are anticipated in the months and years to come.

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COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY, PACIFIC BELL
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Section 11 of the Communications Act of 1934, as amended, requires that the Commission conduct a review of its regulations every two years beginning in 1998.² Specifically, Section 11 states that the Commission “shall review all regulations issued under this Act in effect at the time of the review that applied to the operations or activities of any provider of telecommunications services”³ As a result of this review, the Commission is required to “determine whether any such regulation is no longer necessary in the public interest as the result of meaningful economic competition between providers of such service.”⁴ The Notice of Proposed Rulemaking (“NPRM”) in the above-captioned proceeding is intended to satisfy the biennial review requirements for the Commission’s accounting and cost allocation rules codified

¹ Southwestern Bell Telephone Company (“SWBT”), Pacific Bell and Nevada Bell (“SBC LECs”) are filing these Comments pursuant to the Commission’s Notice of Proposed Rulemaking (“NPRM”) in the above-captioned proceeding released on June 17, 1998.

² 47 U.S.C. § 161.

³ Id. § 161(a) (emphasis added).

⁴ Id. § 161(a)(2).

in Parts 32 and 64 of the Code of Federal Regulations, Title 47. However, the proposals in the NPRM fall woefully short of satisfying the statutory requirements of Section 11. The approach required by Section 11 is a top-to-bottom review of all regulations that apply to the activities of any service provider. The Section 11 Biennial Review of Parts 32 and 64 should include a comprehensive review of all accounting and cost allocation rules. Instead, the NPRM only proposes to streamline a handful of accounting and cost allocation requirements. Moreover, instead of considering how these regulations affect “any provider,” the NPRM excludes almost 90% of the local exchange industry from all but a token few of its streamlining proposals. As explained below, the Commission cannot justify excluding the Bell Operating Companies (“BOCs”) and the GTE Operating Companies (“GTE”) from the scope of its Section 11 Biennial Review.

I. INTRODUCTION

On May 8, 1998, SBC filed its Petition for Section 11 Biennial Review (“Section 11 Petition”) which requested that the Commission undertake the complete review of regulations required by Section 11. SBC’s Section 11 Petition included a list of numerous regulations which are no longer necessary in the public interest. The regulations identified in SBC’s Section 11 Petition included a number of accounting and cost allocation requirements codified in Parts 32 and 64 of the Commission’s Rules. Many of the accounting and cost allocation requirements identified in SBC’s Section 11 Petition are not included in the scope of review proposed in the NPRM. In order to properly perform an exhaustive review of all rules and regulations in this area, the Commission should expand the scope of its review in this proceeding to include, at a minimum, all of the accounting and cost allocation requirements identified in SBC’s Section 11

Petition as well as USTA's and other ILECs' proposals.⁵ Specifically, the scope of the Section 11 Biennial Review in this proceeding should be expanded to include the following proposals from SBC's Section 11 Petition: (1) all of the Part 32 accounting requirements listed in Exhibit B of SBC's Section 11 Petition (copy attached to these Comments) including recordkeeping, depreciation and notification requirements;⁶ (2) all of the Part 64 cost allocation requirements listed in Exhibit D of SBC's Section 11 Petition (copy attached to these Comments), including simplification of the Cost Allocation Manual in fifteen different respects;⁷ and, (3) the requirements of the Part 32 affiliate transaction rules identified on pages 36-37 of SBC's Section 11 Petition (copy attached to these Comments).⁸ The NPRM makes but one fleeting reference to SBC's Section 11 Petition and largely ignores the comprehensive review of accounting and cost allocation requirements sought by SBC as part of that Petition. The accounting and cost allocation requirements described in SBC's Section 11 Petition should be examined in detail in this proceeding, including opportunity for comment on each regulation identified as to whether it is no longer necessary in the public interest as the result of meaningful economic competition

⁵ Other ILECs and USTA have also submitted suggestions for relief from the burdens of the accounting and cost allocation rules, which the NPRM has also ignored almost entirely. See, e.g., Letter dated March 12, 1998 from Gerald Asch, Director Federal Regulatory, Bell Atlantic, to José Rodriguez, FCC; Letter dated March 13, 1998 from Robert T. Blau, Vice President-Executive and Federal Regulatory Affairs, BellSouth, to Richard Metzger, FCC; Letter dated February 19, 1998 from Porter E. Childers, Executive Director-Legal & Regulatory Affairs, USTA, to Kenneth P. Moran, FCC. See also Letter dated April 7, 1998 from Jeannie Fry, Director-Federal Regulatory to Kenneth P. Moran, FCC.

⁶ SBC Section 11 Petition at 9-10, 11-13, 15-16 & Exhibit B.

⁷ Id. at 34-35.

⁸ The pertinent portions of SBC's Section 11 Petition are attached as Exhibit 1 to these Comments.

between providers of service.⁹ Further, that statutory standard for the Section 11 review needs to be examined in order to properly apply it to the Section 11 review of accounting and cost allocation requirements.

As SBC explained in its Section 11 Petition, the standard for Biennial Review should include a quantitative or qualitative analysis of the cost of regulation as compared to its expected benefit¹⁰ and yet, nowhere in the NPRM has the Commission estimated the cost of any accounting or cost allocation requirements, or sought input concerning the cost or burden of these regulations, or conducted any meaningful cost/benefit analysis.

As demonstrated in Arthur Andersen's Whitepaper, "Accounting Simplification in the Telecommunications Industry" filed on July 15, 1998,¹¹ the accounting, recordkeeping and cost allocation requirements are among the most burdensome compared to ILECs' competitors and other industries, the most excessive compared to what is truly necessary in today's environment, and the most ripe for review and comprehensive simplification. And yet, if the scope of review in this proceeding is not broadened, the Commission will miss the perfect opportunity to redirect its role consistent with the forward-looking blueprint that should guide it into the next millennium.

⁹ SBC is also seeking a biennial review of a number of other regulations, including several other accounting-related requirements that are not codified in Part 32. The FCC should also conduct a biennial review of these other regulations, including the ARMIS requirements and the Part 65 lead-lag study requirements. SBC Section 11 Petition at 10-11, 13-14 & Exhibits A & C.

¹⁰ SBC Section 11 Petition at 5-6.

¹¹ Arthur Andersen LLP, "Accounting Simplification in the Telecommunications Industry," filed July 15, 1998 (the "Arthur Andersen Whitepaper").

II. ALL ILECS SHOULD BE PERMITTED TO USE CLASS B ACCOUNTS.

SBC's Section 11 Petition showed why accounting and cost allocation rules should be streamlined, especially for those ILECs that are governed by price cap regulation.¹² These rules are hold-overs from rate-of-return regulation; as they have little, if any, relevance to the rate-setting process for regulated services. As demonstrated in SBC's Section 11 Petition, SBC is facing significant and escalating levels of local exchange competition.¹³ The level of economic competition is especially high in metropolitan areas served in large part by the BOCs. Given the high level of competition and the evolution toward rate-setting that does not rely upon detailed, embedded book costs, especially for price cap carriers, who are no longer subject to any sharing mechanism, detailed accounting, recordkeeping and cost allocation requirements are no longer necessary in the public interest. It is simply not in the public interest to continue requiring price cap ILECs to comply with excessively and unnecessarily detailed accounting, recordkeeping and cost allocation requirements, designed for a rate-of-return environment, when their competitors' activities are not subject to any of the same type of regulatory impediments at all.

While the long-term goal should be to eliminate the Part 32 accounting rules and to permit carriers instead to use Generally Accepted Accounting Principles ("GAAP"), in the interim, as a transitional step toward GAAP, ILECs should be permitted to use Class B accounts. This transitional step is necessary because some accounting information is necessary for the Part 36 jurisdictional separations process, which must continue until it is no longer necessary to

¹² SBC Section 11 Petition at 6-9, 11-13, 15, 34-35 & 36-37.

¹³ Id. at 6-8.

separate costs between the interstate and state jurisdictions.¹⁴ In effect, the separations process must continue, in some fashion, until ILEC pricing decisions are made solely with reference to marketplace considerations or are subject only to one regulatory agency having sole responsibility.¹⁵ The separations process does not require Class A accounts; it can function equally well for a company using Class B accounts. In fact, there is only one, minor difference between the separations procedures used by Class A and Class B companies; otherwise, Class A and Class B companies separate their costs in the same fashion.¹⁶

In contrast to SBC's Section 11 Petition, the NPRM tentatively concludes that the relief from detailed Class A accounts should be limited to mid-sized ILECs. The NPRM's reasons for this tentative conclusion are two-fold. First, the Commission believes it can maintain the necessary degree of oversight of "90% of the industry" (i.e., the BOCs and GTE) by applying Class B accounts to the mid-sized ILECs because mid-sized ILECs allegedly have a much lower level of "competitive" activity, and thus, less opportunity to cross-subsidize. Second, the NPRM contends that the Commission needs Class A accounting information to satisfy its statutory obligations under Sections 260, 271 - 276, and 254(k) of the Communications Act. The NPRM

¹⁴ See Comments of SBC Communications Inc., Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, CC Docket No. 80-286, filed December 10, 1997, at 4.

¹⁵ Id.

¹⁶ The NPRM states that there are "several instances" where Class A and Class B companies perform separations procedures in a different manner. NPRM, n. 9. However, the only Part 36 procedure that is different for Class A and Class B companies is the allocation of Land and Support Assets in Account 2110 (also known as General Support Facilities). See 47 C.F.R. § 36.112.

explains that the “level of detail of the Class A accounting rules allows us to identify potential cost misallocations beyond those revealed by the Class B system of accounts.”¹⁷

Under Section 11, the Commission needs to consider the high level of competitive activity facing the ILECs, both the mid-sized and the largest ILECs. The meaningful economic competition throughout the local exchange industry is the criteria for removing or streamlining regulations such as Class A accounting which is no longer necessary in the public interest. The NPRM’s analysis misapplies Section 11 because instead of removing or streamlining regulation where there is more competitive activity, the NPRM uses the contention that there is a higher level of competitive activity among the largest ILECs as a justification for retaining the detailed Class A regulation only in the case of the largest ILECs. In any event, both grounds for limiting the relief from Class A accounts to mid-sized ILECs are unfounded, as discussed below.

Relief from Class A accounts should not be limited to the mid-sized ILECs, as proposed in the NPRM. The reasons provided in the NPRM do not justify such limited relief from the burden of Class A accounting requirements.

First, unlike Section 10, Section 11 does not expressly contemplate removal of a regulation with respect to an individual “class of telecommunications carriers.”¹⁸ The focus of the inquiry and analysis under Section 11 is much different than that of Section 10.¹⁹ Even if relief for a “class” of carriers is available under Section 11, the “class” should be drawn using

¹⁷ NPRM, ¶ 6.

¹⁸ 47 U.S.C. § 160(a).

¹⁹ See 1998 Biennial Regulatory Review - Testing New Technology, CC Docket No. 98-94, Notice of Inquiry FCC 98-118, released June 11, 1998, ¶¶ 3, 4, 16-24 (Section 11), 25-33 (Section 10).

reasonable criteria that are based on the standard for Section 11 review. Size alone is not a sufficient basis for drawing the lines for a “class” under Section 11.

Under the reasoning of Illinois Public Communications Association v. Commission,²⁰ the Commission will not be able to justify the differential treatment of the BOCs and GTE compared to the mid-sized ILECs. Simply stated, the two factors used by the NPRM to justify such differential treatment do not support it and the NPRM has ignored factors such as price cap regulation and local exchange competition, which justify relief from detailed Class A accounting requirements for price cap ILECs, and, perhaps, all ILECs.

In Illinois Public, the court struck down the Commission’s interim compensation plan for 800 and access code calls from payphones, because the court found the Commission had acted arbitrarily and capriciously in requiring payments only from large interexchange carriers (“IXCs”). The court questioned the Commission’s administrative convenience justification and reasoned that “administrative convenience cannot justify an interim plan that exempts all but large IXCs from paying for the costs of services received.”²¹ Likewise, the Commission will not be able to justify exempting all but the largest six ILECs from the burden of Class A accounting requirements, particularly when the basis for the partial exemption is unfounded.²² Furthermore, the NPRM’s reasoning ignores factors that justify relief for the largest ILECs.

²⁰ 117 F.3d 555, 565 (D.C. Cir. 1997) (“Illinois Public”).

²¹ Id. at 565.

²² Although the FCC does not expressly identify “administrative convenience” as the basis for its proposal in the NPRM, describing the proposal in terms of being able to regulate the accounting of “90% of the industry” by only including 6 companies in the scope of its most detailed accounting regulations suggests an “administrative convenience” rationale that is unrelated to the benefit of its regulatory activity.

The NPRM's first reason for its partial exemption is that "the largest incumbent LECs tend to conduct a much greater transactional volume of competitive services than the smaller and mid-sized carriers [and thus], there is a greater risk of harm to consumers and competitors from cross-subsidization among these carriers."²³ In reality, the level of competitive or nonregulated activity is not so different at the mid-sized companies compared to the largest ILECs. On the contrary, the percentage of nonregulated activity reported by a typical mid-sized company is comparable to or greater than the percentage of nonregulated activity reported by the BOCs. Charts comparing the level of nonregulated activity at some of the larger mid-sized companies to GTE and the BOCs' nonregulated activity are attached as Exhibit 2.

As the following figures from 1997 reflect, the NPRM's assumptions regarding differences in the level of nonregulated activity at the mid-sized ILECs is flawed:

	<u>Operating Expenses</u>	<u>Nonregulated</u>	
		<u>Total Expenses</u>	<u>Investment</u>
10 Mid-Sized ILECs	17.7%	15.6%	4.3%
SBC LECs	8.6%	7.0%	1.8%
6 Largest ILECs	9.2%	6.4%	2.0%

In fact, in most cases, the mid-sized ILECs have a higher level of nonregulated activity than the SBC LECs. For example, on the average, about 17% of the mid-sized ILECs' operating expenses are attributable to nonregulated activities, as compared to only 8.6% of the SBC LECs' operating expenses. Eight of the ten mid-sized ILECs listed in Exhibit 2 to these Comments had more than 13% of their operating expenses go to nonregulated in 1997, as compared to only 8.6% for the SBC LECs. No matter what basis of comparison is used, the typical mid-sized ILEC had more nonregulated activity relative to its total operations than the SBC LECs. The

²³ NPRM, ¶ 12 (emphasis added).

mid-sized ILECs have not only relatively more nonregulated expenses, they also have more nonregulated revenue (10.3% vs. 6.3%) and investment (4.3% vs. 1.8%) than the SBC LECs. The same is true of the mid-sized ILECs as compared to the six largest ILECs as a group. The six largest ILECs, with 6½% nonregulated expenses, have a much lower level of nonregulated activity compared to the mid-sized ILECs in Exhibit 2, with 15½% nonregulated expenses. Therefore, contrary to the NPRM's assumption, the relative amount of competitive or nonregulated activity is higher in many cases for mid-sized carriers as compared to the largest ILECs.

For example, if one is comparing a BOC to a mid-sized company that has one-fourth as much total revenue, it is true that the mid-sized company would have a smaller number of total nonregulated sales transactions; however, the number of nonregulated sales for each regulated sale would be higher at the mid-sized ILEC as compared to a BOC, as the ARMIS data shows. Accordingly, the relative degree of theoretical risk of harm to ratepayers from cross-subsidization is certainly no less for the mid-sized ILECs as compared to the largest ILECs. Even for the mid-sized ILECs with the lowest levels of nonregulated activity, the theoretical "opportunities to subsidize competitive services" are roughly the same for both groups relative to their respective size. Therefore, it would be arbitrary to exempt mid-sized carriers from the onerous burden of Class A accounting while continuing to impose those same detailed safeguards on the largest ILECs. The ratepayer of the largest ILECs is no less deserving of relief from the indirect cost of Class A regulation than the ratepayer of the mid-sized company. In fact, given the protection provided by price cap regulation and local exchange competition, the largest ILECs have a better case for relief from the burden of unnecessary and outmoded regulation than many of the mid-sized ILECs.

While the relative amount of nonregulated or competitive products and services is not a basis to distinguish mid-sized ILECs from the largest ILECs, there are at least two significant distinguishing factors the Commission should consider in its Section 11 analysis. First, all of the largest ILECs are subject to price cap regulation and the Commission has eliminated the sharing mechanism that provided a direct link between accounting costs and prices. Second, the BOCs are subject to a greater level of local exchange competition than the mid-sized ILECs because the BOCs are more heavily concentrated in the large metropolitan areas where local exchange competition is most intense.

SBC submits that there are ample reasons to exempt all ILECs from the Class A accounting requirements. The main reason that across-the-board relief is justified is that Class A accounts are no longer necessary for the Commission to perform essential regulatory functions. As explained above, Part 36 separations can function using Class B accounts. Further, the Commission can maintain the necessary degree of oversight and monitoring of all ILECs even if the ILECs use Class B accounts. The NPRM acknowledges that the Commission can maintain the necessary oversight to prevent cross-subsidy of competitive or nonregulated activities at the mid-sized companies. This is no less true in the case of the largest ILECs. The NPRM does not provide any valid reason for concluding that Class A accounts are essential to identify potential cost misallocations. In fact, the primary safeguard against cross-subsidy (aside from price cap regulation), the Part 64 cost allocation rules, can function equally well using Class B accounts as it does using Class A accounts. To the extent that any regulatory mechanism such as the Part 64 cost allocation rules is still necessary in the public interest and requires detailed accounting data, that data is available from underlying accounting records. Thus, the necessary data can be maintained even if an ILEC uses Class B accounts.

A separate reason provided by the NPRM for continuing to apply the Class A accounts to the largest ILECs is to enable the Commission to ensure compliance with Sections 260, 271-276 and 254(k) of the Communications Act.²⁴ A closer examination of the existing safeguards reveals that the Commission can enforce these sections even if an ILEC uses Class B accounts. The primary accounting safeguard with which these sections are concerned is the protection of ratepayers from cross-subsidizing nonregulated or competitive activities. Aside from price cap regulation, the same Part 64 cost allocation discussed above, as implemented in a carrier's individual Cost Allocation Manual ("CAM"), is the primary regulatory tool to protect ratepayers from cross-subsidy, as required by provisions of these sections. As acknowledged in the Accounting Safeguards Order, the existing CAM requirements satisfy the accounting safeguard provisions of these statutory sections.²⁵ A Class B CAM is equally as effective as a Class A CAM in performing this regulatory function.

Whether a carrier uses a Class A CAM or a Class B CAM, costs will continue to be fully allocated between regulated and nonregulated activities using the same types of homogenous cost categories. There is no reason to believe that the cost pools in a Class B CAM will be any less detailed than those in a Class A CAM. Thus, the accuracy of the CAM process will not be affected at all by a change from Class A to Class B because the underlying cost pools will continue to contain all the necessary details concerning costs.

To the extent that misallocation of costs of nonregulated or competitive activities continues to be a concern, it is a concern that is equally applicable to the mid-sized and the

²⁴ NPRM, ¶¶ 6, 12.

²⁵ Accounting Safeguards Order, CC Docket No. 96-150, 11 FCC Rcd 17539, ¶¶ 4-13, 24-26, 50, 108 (1996).

largest ILECs, except to the extent this concern is reduced by price cap regulation applicable to the largest ILECs and some of the mid-sized ILECs. While these same concerns are reflected in the statutory sections upon which the NPRM relies, these sections as well as the pre-existing cross-subsidy concerns can all be satisfied even if the ILEC uses the Class B CAM. Thus, these sections are not a reason to require any ILEC to use a Class A CAM.

The NPRM states that the Commission needs Class A accounts for the largest ILECs to uphold its statutory obligations under Sections 260, 271-276 and 254(k). However, even assuming that there were truly a reason to require Class A accounts for purposes of any of these sections—which SBC has demonstrated there is not—two of these sections, 260 and 254(k), are applicable to all ILECs. Therefore, based on the NPRM's assumption that Class A accounts are necessary to perform the Commission's duties under these sections, it is unclear how the Commission believes it will be able to satisfy the requirements of Sections 260 and 254(k) with respect to mid-sized ILECs that would no longer maintain Class A accounts. In any event, SBC submits that the issue is moot because Class A accounting details are not necessary for purposes

of any of these sections.²⁶

The NPRM presents all of these statutory sections as support for retaining Class A accounts for the largest ILECs, but it does not discuss in any detail why Class A accounts are needed for compliance with these sections, other than Section 254(k). In the case of the only section discussed in any detail, Section 254(k), the NPRM only provides superficial analysis. The NPRM indicates that Class A accounts are necessary to assure compliance with Section 254(k)'s mandate that "a telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition"²⁷ because "[t]he level of detail of the Class A accounting rules allows us to identify potential cost misallocations beyond those revealed by the Class B system of accounts."²⁸ However, the NPRM does not explain exactly how Class A "provides more refined cost allocations."²⁹ The SBC LECs do not agree with the NPRM's reasoning. As explained above, the ILEC's CAM will provide the same level of detail

²⁶ It is interesting to note that while the NPRM relies upon the Commission's statutory duties under a number of new provisions added by the 1996 Act, including two sections applicable to all ILECs, the NPRM fails to mention the Commission's duties under Section 251. While the Commission's limited interstate responsibilities under Section 251 do not require the retention of Class A accounts, it was surprising not to see Section 251 in the laundry list of statutory sections that the NPRM considered pertinent, especially given the attention focused on accounting for Section 251 activities in CC Docket No. 97-212, Amendments to Uniform Systems of Accounts for Interconnection, FCC 97-355, released October 7, 1997. Given that the NPRM considers so many other sections of the 1996 Act to be pertinent to its analysis, the omission of Section 251 should be explained in the complete Section 11 analysis. Certainly, the scope of these sections does not appear to have been among the criteria for their selection. If any of these sections were pertinent to the issue of retaining Class A accounts, Section 251, like Sections 260 and 254(k), would not support retaining Class A accounts only for the BOCs and GTE.

²⁷ 47 U.S.C. § 254(k)

²⁸ NPRM, ¶ 6.

²⁹ Id.

whether the ILEC uses Class A or Class B accounts. The only necessary difference in the CAM is that the cost pools will be organized under a fewer number of accounts. This is merely a difference in form that does not have any substantive impact on the accuracy of cost allocation. Thus, there is little, if any, loss in the refinement of the cost details provided by a Class B CAM compared to a Class A CAM. Even if there were some loss in detail as a result of reorganizing cost pools, this should not be a concern in view of other developments such as price cap regulation, elimination of the sharing mechanism and local exchange competition. These developments significantly reduce the need to police potential cost misallocations, especially for price cap ILECs.³⁰

In any event, the NPRM's focus on Section 254(k) illustrates the arbitrary nature of the proposed classification of only the six largest ILECs as Class A companies, even though all ILECs are subject to Section 254(k)'s mandate. If retention of Class A accounts for the six largest ILECs is essential for the Commission to assure compliance with Section 254(k)'s

³⁰ The NPRM provides one specific example from the Commission's experience in support of its contention that Class A accounts are needed to identify improper cost allocations. NPRM, n. 19. However, the example does not support the retention of Class A accounts. Mainly, it ignores the effectiveness of the CAM in identifying regulated and nonregulated costs in more than sufficient detail regardless of the detail of the main accounts. The NPRM claims that having Account 7370 (Special Charges) enabled the Commission to identify misclassified lobbying costs. However, lobbying costs are not the only type of costs included in Account 7370. Other types of special charges are also included in Account 7370 such as charitable contributions, membership fees, penalties and fines and abandoned construction projects. Therefore, whether or not ILECs maintain Account 7370, information on the expenses recorded in that account is not sufficient to identify lobbying expenses. Instead, one would need to look at the internal accounting details maintained by ILECs. In fact, this is what the Commission staff did in the case of lobbying, as the BOCs received requests for internal accounting data after Allnet filed a formal complaint. Therefore, if lobbying expenses were recorded in Class B Account 7300, this would not impair the Commission's ability to obtain the same type of internal accounting data concerning lobbying expenses included in Account 7300. In either case, whether lobbying expenses are recorded in Account 7300 or Account 7370, the Commission has to obtain internal accounting data in order to specifically identify lobbying expenses.

mandate, then it is no less essential for the Commission to uphold that statutory obligation with respect to the much greater number of remaining ILECs. This is especially true given that all of the largest ILECs are subject to price cap regulation; whereas, only a fraction of the remaining ILECs are subject to that safeguard. A more reasonable conclusion based on the entire record presented to the Commission so far would be that the Section 11(a)(2) standard has been satisfied for all ILECs, including both the mid-sized ILECs and the largest ILECs.

In conducting the Section 11 biennial review of all accounting and cost allocation rules in this proceeding, the Commission should use the cost/benefit approach described in Commissioner Furchtgott-Roth's Separate Statement: Do "the benefits outweigh the burden imposed?"³¹ Because there is little, if any, remaining benefit from applying antiquated rate-of-return era regulations such as these to price cap ILECs, the detailed accounting and cost allocation rules are clearly outdated and unjustified. The Commission recognized the reduced role of accounting and cost allocation in discussing the anticipated benefits of price cap regulation without a sharing mechanism in a competitive environment:

[E]limination of sharing reduces our reliance on, and thus the importance of, jurisdictionally separated embedded costs. The sharing obligation is triggered when a price cap carrier reports interstate earnings above a specified level. Reported earnings are calculated on the portion of embedded investment and expenses that are allocated to the interstate jurisdiction by Part 36, the jurisdictional separations manual. Interstate rate base and expense levels, and thus reported earnings, are also directly affected by accounting depreciation rates, which we prescribe for most incumbent price cap LECs. By contrast, in a competitive marketplace, decisions are governed by economic costs and economic

³¹ NPRM, Separate Statement of Commissioner Furchtgott-Roth.

depreciation rates. Reduced reliance on accounting costs thus facilitates our transition to the competitive paradigm of the 1996 Act.³²

Likewise, Court's analysis in Illinois Public of the valuation of payphone assets for purposes of the affiliate transaction rules recognizes that price cap regulation changes the allocation of risks and burdens of business activity in a manner that requires the Commission to reconsider its accounting and cost allocation rules as applied to price cap ILECs.³³ The Commission can no longer assume that the booking and allocation of investment and expenses under Parts 32 and 64 will have much, if any, impact on rates.

Certainly, given the reduced importance of Part 32 book costs, the same intense regulation of accounting that was adopted under rate-of-return regulation is no longer justified under price cap regulation. And, in any event, in view of the NPRM's inability to distinguish mid-sized ILECs from the largest ILECs, the latter, all being subject to price cap regulation, are entitled to no less deregulatory relief than the mid-sized ILECs.

III. A DEREGULATORY REVIEW OF THE POLE ATTACHMENT RULES IS REQUIRED BY SECTION 11.

The NPRM inquires "whether mid-sized ILECs should be required to maintain Class A accounting details used to calculate the maximum fees under the current pole attachment formulas if they opt to use Class B accounts."³⁴ In SBC's view, all ILECs should be permitted to

³² Price Cap Performance Review of Local Exchange Carriers, CC Docket No. 94-1, 12 FCC Rcd 16642 ¶ 152 (1997) ("Price Cap Order").

³³ Illinois Public, 117 F.3d at 569-70. Cf. California v. FCC, 39 F.3d 919, 926 (9th Cir. 1994) (The "FCC has . . . demonstrated that the BOCs' incentive and ability to cross-subsidize will be significantly reduced.")

³⁴ NPRM, ¶ 7.